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# Supreme Court of the United States

OCTOBER TERM, 1953

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PHILLIPS PETROLEUM COMPANY, *Petitioner,*

v.

STATE OF WISCONSIN AND PUBLIC SERVICE COMMISSION OF WISCONSIN, CITY OF DETROIT, MICHIGAN, CITY OF KANSAS CITY, MISSOURI, CITY OF MILWAUKEE, a municipal corporation, COUNTY OF WAYNE, MICHIGAN and THE FEDERAL POWER COMMISSION, *Respondents.*

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## REPLY BRIEF FOR PETITIONER PHILLIPS PETROLEUM COMPANY

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RAYBURN L. FOSTER
HARRY D. TURNER
KENNETH HEADY
Phillips Building
Bartlesville, Oklahoma

HUGH B. COX
STANLEY L. TEMKO
BURKE MARSHALL
Union Trust Building
Washington 5, D. C.
*Attorneys for Petitioner*

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## REPLY BRIEF FOR PETITIONER PHILLIPS PETROLEUM COMPANY

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### I. THE WORDS "PRODUCTION OR GATHERING" IN SECTION 1(b) DESCRIBE A SEGMENT OF THE NATURAL GAS INDUSTRY AND NOT, AS RESPONDENTS ASSERT, A DOCTRINE OF CONSTITUTIONAL LAW

The basic issue here is one of statutory construction, *i.e.*, what meaning is to be given to the words "production or gathering of natural gas." Phillips' position is that the words, given their ordinary meaning and read in context and against the background of the

legislative history, mean the business or economic function of production and gathering (Phillips' brief, pp. 19-45). Respondents reject this meaning of the words and as a result when they attempt to square their contentions with the provisions of the statute they become involved in difficulties, ambiguities and inconsistencies which make it impossible for them to advance a consistent and coherent interpretation of the statutory language.

From the fact that when Congress passed the Natural Gas Act it intended to close a "gap" in the regulatory authority, the Respondents attempt to draw the conclusion that the words "production or gathering" are to be interpreted and applied solely by reference to limitations that Respondents assert exist on the constitutional powers of the states.

Respondents' argument on this point assumes different forms at different points in their brief. At times they contend broadly that all sales for resale in interstate commerce are beyond the constitutional powers of the states to regulate and hence that no such sale can be covered by the words "production or gathering" in Section 1(b) (Respondents' brief, p. 28). On this reading of the statute, federal regulatory power extends to all sales for resale in interstate commerce including those made at the well-head. And since it would not be possible to give one meaning to the affirmative provision of Section 1(b) relating to sales for resale and a different meaning to the coordinate and parallel affirmative provision relating to transportation, this reading of the statute also means that all interstate transportation of natural gas, even though it occurs in the course of gathering, is subject to federal regulation and that the only gathering excluded

from regulation is the gathering of gas which never moves to an interstate destination.

Respondents shrink from the consequences of this interpretation of the statute and at other points in their brief they appear to take the position that federal regulation does not extend to all but only to some sales for resale in interstate commerce. Thus respondents appear to concede that sales made at the well-head are not subject to regulation because such sales may be regulated by the states under the decision of this Court in *Cities Service Gas Co.* v. *Peerless Gas & Oil Co.*, 340 U.S. 179 (Respondents' brief, pp. 35-36). On this reading of the statute the words "production or gathering" exclude from federal power *some* but not *all* sales for resale in interstate commerce and the test for determining whether particular sales are subject to federal regulation is whether the states have the power to regulate the sales in question.

If it is assumed, as this interpretation of the statute does, that the words "production or gathering" cover some sales, the words themselves supply no basis for a distinction between sales that rests on the constitutional power of the states. On the contrary, the only reasonable basis for determining what sales are covered, and the only one consistent with the ordinary usage of the words and with the intent of Congress as evidenced by the legislative history, is whether the sales are a part of the economic function or operation that the words "production or gathering" describe. Respondents make no serious argument that the words "production or gathering", in themselves, provide any support for a distinction between sales based on doctrines of constitutional law. To support the asserted distinction the Respondents rely largely on extrinsic materials in the legislative history which they assert show that

Congress intended to close a gap in regulatory authority. In our main brief we have pointed out that although Congress admittedly intended to close a gap in regulatory authority, the gap that it intended to close was a gap in the authority of the states to regulate the activities of the interstate transmission companies and not a gap that related in any way to field sales made by independent producers or gatherers (Phillips' brief, pp. 38-40). The Respondents also attempt to support their argument by reference to statements by this Court that the statute was intended to close a gap in regulatory authority. Those statements, as we have also shown in our main brief, were directed to the gap in the authority to regulate the activities of the interstate transmission companies and do not sanction the extension of federal authority to any aspect of the business of independent producers and gatherers (Phillips' brief, p. 52).

Whenever the Respondents leave these extrinsic materials and attempt to support their general position by reference to the words of the statute, they become involved in additional difficulties. For example, at page 44 of their brief they assert that "matters specified in the affirmative provisions of Section 1(b) are not included in the negative provisions of that section." The matters specified in the affirmative provisions of Section 1(b) are sales in interstate commerce for resale and transportation in interstate commerce. Accordingly, this contention means that the words "production or gathering" in Section 1(b) cannot cover any sales for resale in interstate commerce or any transportation of natural gas in interstate commerce. Furthermore, on this reading of the statute, questions of state power are irrelevant because the application of the statute follows necessarily and auto-

matically from the affirmative provisions of Section 1(b) without regard to questions of constitutional power.

Here again Respondents shrink from the consequences of their argument particularly as it applies to transportation. They realize that their argument, if accepted at face value, means that all transportation of gas during gathering is subject to federal regulation if the gas is moving toward an interstate destination. They therefore assert that the word "transportation" in the affirmative provisions of Section 1(b) does not cover all movement in interstate commerce but only some movement. And they further assert that the distinction between the interstate movement that is covered by the affirmative provisions of Section 1(b) and the movement that is not covered depends on whether there is continued commingling of gas within the particular pipe in which the gas is moving (Respondents' brief, p. 44).

The word "transportation" standing alone in the affirmative provisions of Section 1(b) does not provide a basis for this alleged distinction. If the statute distinguishes between some transportation in interstate commerce and other such transportation, that distinction must be found in the words "production or gathering" in the concluding clause of Section 1(b). Respondents appear to recognize this fact because at other points in their argument they attempt to distinguish between the movement in interstate commerce covered by the statute and the movement excluded from regulation by arguments addressed to the meaning that they contend should be given to the word "gathering" in the exemptive clause of Section 1(b) (Respondents' brief, p. 39, note 8). This recognition

that the word "gathering" does cover some transportation in interstate commerce is necessarily inconsistent with Respondents' broad assertion that the matters specified in the affirmative provisions of Section 1(b) are not covered by the negative provisions of that section.[1]

The significant point in this discussion is not that the Respondents have fallen into minor or inconsequential inconsistencies. The important point is that the Respondents are unable to come forward with a coherent and consistent interpretation of the statute. At points in their argument they seem to recognize that not all sales for resale in interstate commerce and not all transportation in interstate commerce are subject to federal regulation. But the question is what sales and transportation are excluded from regulation. Our position is that the question whether particular sales or particular transportation is subject to regulation depends upon whether the transportation or the sales are a part of the economic operation or function that is described by the words "production or gathering". In contrast, when the Respondents attempt to articulate a standard for determining what sales and transportation are subjected to regulation, they fall into the

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[1] Respondents fall into a further inconsistency when they assert that the words "production or gathering of natural gas" cannot mean "anything other than a physical activity" (Respondents' brief, p. 41). If this is so all sales for resale in interstate commerce are subject to regulation; yet Respondents themselves appear to recognize that the statute does not apply to any sales that are subject to state regulation under the decision of this Court in the Cities Service case. This contention is also flatly inconsistent with the statement by this Court in the Interstate case that in appropriate circumstances the words "production or gathering" in Section 1(b) exclude from regulation sales even though made by an interstate transmission company.

difficulties, ambiguities and inconsistencies that have been described above. These infirmities in Respondents' arguments are the result of their refusal to accept the fact that the words "production or gathering" describe a business or segment of the natural gas industry and neither embody a doctrine of constitutional law nor reflect the esoteric and unexpressed distinctions suggested by Respondents.

Our principal brief has shown that Congress intended to regulate the business of the interstate transmission companies which transport gas from the producing fields to consumer markets (Phillips' brief, pp. 27-45). The words that Congress used in the Natural Gas Act to describe the scope of the regulation are words that describe this interstate transmission business and do not describe or provide for regulation of either of the other two segments of the natural gas industry, that is to say, the business of producing or gathering or the business of local distribution (Phillips' brief, pp. 19-27). If the words of the statute are read as applying to a particular segment of the natural gas industry, *i.e.*, the interstate transmission of gas from the producing fields to consumer markets, which is the meaning that Congress intended, and a meaning that is consistent with the ordinary significance of the words, the statute can be interpreted and applied as a coherent and consistent whole. On that basis the whole of the business of producing and gathering is excluded from federal regulation. On the other hand any attempt to divide or segment the business of producing and gathering and to subject some parts of it to regulation and to exclude others, on the basis of distinctions not expressed in the statute and not consistent with the meaning of its words or

with the intent of Congress, inevitably involves all of the inconsistencies, ambiguities and difficulties that are displayed in Respondents' argument.

## II. The Commission's decision leaves no gap in regulatory authority

The Respondents contend that the effect of the Commission's decision holding that Phillips' sales are not subject to regulation under the Natural Gas Act is to create a gap in regulatory authority. This contention is unfounded.[2]

Under the decision of this Court in *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179, the states have authority to regulate Phillips' sales. The Respondents concede, as they must, that the *Cities Service* case held that the State of Oklahoma had power under the constitution to regulate sales of natural gas in interstate commerce. Respondents contend, however, that Phillips' sales are distinguishable from the sales involved in the *Cities Service* case. The grounds of distinction asserted by Respondents are without merit. It cannot be disputed that the sales in the *Cities Service* case were in interstate commerce. It also cannot be disputed that they were sales for resale since Cities Service bought the gas to sell to others, and not to use itself.

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[2] In making this argument Respondents assert that the Oklahoma price regulation does not apply to the sales that are involved in the instant case. This is incorrect. The price order issued by the State of Oklahoma applies to all of the gas produced by Phillips in the Guymon-Hugoton Field, including gas that Phillips sells to Michigan-Wisconsin Pipe Line Company and Panhandle Eastern Pipe Line Company, two of the sales involved in this case. See Phillips Petroleum Company v. Oklahoma, 340 U.S. 190. See also, Phillips' brief, p. 66.

Respondents assert, however, that Phillips' sales, unlike the sales in the *Cities Service* case, are sales of "national" and not "local" concern (Respondents' brief, p. 35). The reasons advanced by Respondents in support of this contention will not bear examination. The first reason advanced by Respondents rests upon the alleged "magnitude of the operations by Phillips and the impact of its charges upon the consuming public in distant states" (Respondents' brief, p. 32). Whether sales are of national or local concern within the meaning of the doctrine laid down in the *Cities Service* case does not depend upon the volume of gas involved in particular sales. Nothing in the opinion in the *Cities Service* case suggests that the decision by the Court there rested on the fact that the sales to Cities Service were small. On the contrary, the opinion of the Court dealt with the Oklahoma regulation in terms of its application to the entire Oklahoma portion of the field and on that basis the volume of gas affected by the Oklahoma regulation was greater than the volume of gas involved in Phillips' transactions. The Court recognized in that case that ninety per cent of the gas affected by the regulation was ultimately consumed outside the borders of the State of Oklahoma. This shows that there is nothing in Respondents' contention that Phillips' sales are of national rather than local concern because the gas is ultimately consumed at a number of points beyond the borders of the states where the gas is produced.

The Respondents also contend that the decision of this Court in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157, shows that Phillips' sales to the interstate pipe line companies are not a local activity (Respondents' brief, p. 32). This contention rests upon a misreading of the Court's opinion in that case. There

this Court held invalid a Texas tax based on the taking of gas by interstate transmission companies from Phillips because that taking was so closely related to interstate transmission that it could not be separated from the transmission and regarded as a separable local activity subject to taxation by the state.

As is pointed out in our principal brief (p. 64, n. 52), this Court did not hold in that case that Phillips' operations, including its sales to the interstate transmission companies, were of national rather than local concern. On the contrary, the opinion of the Court recognized the distinction between the national character of the interstate transmission business and the essentially local character of the business done by Phillips. Thus the Court opened its discussion by stating that "Appellants' business is the interstate transportation and sale of natural gas." 347 U.S. at 165. It stressed that "the tax here is not levied on the capture or production of the gas, but rather on its taking into interstate commerce *after* production, gathering and processing." *Id.* at 169 (emphasis that of the Court). And the Court also emphasized that "the processing, on which the tax is *not* imposed, was done by Phillips and took place prior to the taxable event of 'taking'." *Id.* at 169 (emphasis that of the Court). Finally, the Court's recognition of the essentially local character of Phillips' activities, including its sales, appears clearly from its discussion of the decision in *Utah Power & Light Co.* v. *Pfost,* 286 U.S. 165. In discussing that case, which upheld an Idaho license tax on the generation of electricity in Idaho for transmission to Utah, the Court said that that situation "is analogous to the situation here where the gas is prepared by Phillips for transmission and is then fed into appellants' lines", thus

clearly indicating that Phillips' activities, including its sales to the interstate transmission companies, are local in character. 347 U.S. at 168 n. 6.

## III. The exclusion of gathering applies to gas purchased as well as to gas produced by the gatherer

Respondents contend that Phillips' sales are subject to federal regulation because a part of the gas that Phillips gathers, processes and sells is purchased by Phillips from other producers (Respondents' brief pp. 6, 7, 22, 56-58). In considering this contention it should be remembered that Phillips does not sell gas that has been gathered by others; all of the gas Phillips sells to the interstate transmission companies is gathered by Phillips.

Respondents' contention conflicts with the words of the statute. Section 1(b) provides that the Act shall not apply to "the production *or* gathering of natural gas". These words clearly apply to one who gathers but does not produce as well as to one who both produces and gathers.

There was abundant testimony in this proceeding, both by witnesses for Phillips and by witnesses for the Federal Power Commission's staff, that in the industry the activity of gathering includes the gathering of purchased gas as well as the gathering of gas produced by the gatherer (R. 702-710; see also 5094-5096 in the original stenographic transcript). Moreover, the Commission has consistently treated gathering as including purchased gas as well as gas produced by the gatherer. *H. L. Hunt*, 6 F.P.C. 837; *The Chicago Corporation*, 6 F.P.C. 98; *Kansas-Nebraska Natural Gas Co., Inc. and Kansas Natural Gas, Inc.*, 6 F.P.C. 664, and *Arkansas Louisiana Gas Co.*, 7 F.P.C. 766.

To support their arguments Respondents resort to certain passages in Mr. DeVane's testimony in the hearings on H. R. 11662 relating to changes in ownership of gas. See Respondents' brief, pp. 56-57. Respondents' reliance upon this testimony is clearly misplaced. Mr. DeVane's remarks concerning changes in ownership were directed only to changes in ownership occurring during interstate transmission between the producing fields and the consumer market. This is shown by his words; he stated that under the bill the Federal Power Commission would have "no control of the gathering rate" which would be "fixed by competitive conditions that exist in the field"; he then went on to refer to changes in ownership "between the time the gas starts to move in interstate commerce and gets to the city gates." See Phillips' brief, p. 32, n. 25. Furthermore Respondents themselves take the view that H. R. 11662 applied only to interstate transmission companies; indeed this is the ground for their general contention that Mr. DeVane's testimony should be disregarded. On this basis it necessarily follows that Mr. DeVane was talking about changes in ownership that occur during interstate transmission and not about changes during the production or gathering process.

In this connection Respondents assert on page 58 of their brief that "by the time Phillips sells and delivers natural gas to the five pipeline companies for resale the gas has been and is being transported in high pressure mains so as to be within even the limited scope of the jurisdictional provisions of H. R. 11662." This statement is incorrect. The evidence and the Commission's findings show that neither the lines leading into the processing plants nor the short plant outlets are "high pressure mains." See Phillips' brief, p. 71, n. 58. But aside from its being without factual founda-

tion, Respondents' assertion would make one physical circumstance controlling to the exclusion of all other relevant facts. The question whether Phillips' movements of gas are gathering or statutory transportation does not turn on the question of the pressure in the lines. It turns on the question whether the movement is a part of the economic process or operation of gathering. In this case the Commission found that all of Phillips' lines are gathering lines and not transmission lines. Its findings were fully supported by the evidence. See Phillips' brief, pp. 68-69. This being the case, Phillips' activities were properly held by the Commission not to be subject to regulation.

Respectfully submitted,

RAYBURN L. FOSTER
HARRY D. TURNER
KENNETH HEADY
Phillips Building
Bartlesville, Oklahoma

HUGH B. COX
STANLEY L. TEMKO
BURKE MARSHALL
Union Trust Building
Washington 5, D. C.
*Attorneys for Petitioner*